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BEFORE THE

Supreme Court of the United States

OCTOBER TERM, 1943.

No. 937

ESTATE OF JOHN W. HERBERT, Deceased, CENTRAL HANOVER BANK AND TRUST COMPANY, ET AL., Executors, *Petitioners,*

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent.*

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT, BRIEF IN SUPPORT THEREOF, AND MOTION AS TO RECORD.

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v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent.*

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT.

To the Honorable, the Chief Justice and the Associate Justices:

The petition of the Estate of John W. Herbert, Deceased, Central Hanover Bank and Trust Company, et al., Executors, respectfully shows to this Honorable Court:

A.

SUMMARY STATEMENT OF THE MATTER INVOLVED.

1. Statement of the Case.

John W. Herbert died on August 26, 1934. His executors are the petitioners in this litigation which involves the liability of the estate for income taxes on payments

received by the estate in 1938 and 1939 on account of notes and open book accounts held by the decedent. When Herbert died he had a claim of $531,817.75 (R. 19a) against the People's Realty Company of which he was the sole stockholder. The entire claim originated in cash loans and advances made by the decedent to said company. The parties stipulated that the fair market value of this claim at the date of death was $200,191.90. (R. 19a) The executors to whom the claim passed as an asset of the estate, collected on the claim, by the end of 1937, $155,000.00; in 1938, $127,000.00; in 1939, $500.00 (R. 19a), and interests in two mortgages, having an aggregate fair market value of $13,303.61 (R. 20a). The aggregate of the payments received from the debtor company on account of its total indebtedness to the decedent, or his estate, respectively, therefore amounted to $295,803.61, leaving an unpaid indebtedness of $236,014.14. The executors did not include in the gross income of the estate for 1938 and 1939 any part of the amounts collected over and above the stated fair market value of the claim at the date of death. The Commissioner of Internal Revenue added $81,808.10 (R. 14a), the amount by which collections in 1938 had exceeded the fair market value of the claim, to the ordinary income of the 1938 return, and $13,803.61 (R. 19a), the amount collected in 1939, to the ordinary income on the return of that year. The tax Court, by its Memorandum Opinion of March 4, 1943 (R. 20a-21a), and its decision of May 20, 1943 (R. 21a), sustained the Commissioner and the case was taken for review to the United States Circuit Court of Appeals for the Third Circuit. By its decision of December 30, 1943, to wit, Herbert's Estate et al. v. Commissioner of Internal Revenue, 139 Fed. (2d), Advance Opinions 756, the decision of the Tax Court was affirmed (R. 22-27).

The Commissioner relied on Sections 111, 22(a) and 161(a) (3) of the Revenue Act of 1938, corresponding sections of the Internal Revenue Code and, for judicial precedent, on *Helvering* v. *Roth* (2 Circ. 1940), 115 Fed. (2d) 239.

2. Questions Submitted to the United States Circuit Court of Appeals for the Third Circuit and the Answers Given Thereto in the Decision of that Court.

The petitioners submitted, on appeal, the following questions:

> Is the partial repayment of loans, made by the decedent prior to his death, as far as such repayments exceed the assumed fair market value of the total indebtedness as of the date of death of the decedent, taxable income of the estate?

In particular:

> (a) Does such partial repayment of a loan constitute a "sale or other disposition" of property on the part of the executors as required for the determination of taxable gain under section 111(a) and (b) of the Internal Revenue Code?
>
> (b) Can the doctrine of separate taxable entity of an estate be used to make income out of what is not in truth and substance income?
>
> (c) Is the hypothesis of the "fair market value", in view of the contingencies under which it had to be assumed by the executors in the case at bar, subject to the corrective of subsequent events?
>
> (d) May the mandatory application of a basis under Section 113(a) (5) of the Internal Revenue Code be interpreted as amounting in effect to a statutory write-off of a bad debt to the extent to which the assumed fair market value is below the full amount of the debt?

The United States Circuit Court of Appeals for the Third Circuit Court gave the following answers to the foregoing questions:

It held the partial repayment of loans made by the decedent prior to his death, as far as such payments exceeded the fair market value of the total indebtedness as of the date of the death of the decedent, to be ordinary

taxable income of the estate. In particular, the court held that the payment of the claim held by the estate was a "disposition" of the claim within the meaning of Section 111 of the Revenue Act of 1938 and of the Internal Revenue Code, and, further, that, whatever status a personal representative may have for other purposes, he is treated by the Revenue Acts as a new owner of the decedent's property for income tax purposes and that the claim held by the estate cannot be considered as the expression of a creditor-debtor relationship continued from the decedent unto his executors.

The court also held that Section 22(a) of the Revenue Act of 1938 (corresponding section of the Internal Revenue Code), is broad enough to include the difference between the value of the claim on the date of death and the amount ultimately collected on the claim, in the categories of gross income enumerated in this section. In other words, the court held that the excess collected over the assumed fair market value at the date of death is returnable as ordinary income under section 22(a) of the 1938 Act, or the corresponding section of the Internal Revenue Code, notwithstanding the fact that Congress has prescribed a definite and exclusive method for the determination of gain or loss in the case of a "sale or other disposition" of property in sections 22(f) and 111(a) and (b), respectively; that is to say, the application of Section 111(a) and (b) is mandatory in cases where gain or loss is to be determined as the difference from a given basis, as for example, in the case at bar, from the date of death value basis under Section 113(a) (5) of the Revenue Act of 1938 (corresponding section of the Internal Revenue Code). (R. 3a)

B.

REASONS RELIED ON FOR THE ALLOWANCE OF THE WRIT.

A writ of certiorari should be granted under subdivision 5(b) of Rule 38 of this Honorable Court for the following reasons:

1. A substantial federal question is presented.

In *Helvering* v. *Griffith*, 318 U. S. 371, 87 L. Ed. 843, this Honorable Court expressly refused to overrule its decision in *Eisner* v. *Macomber*, 252 U. S. 189, 64 L. Ed. 521. *Inter alia*, this Honorable Court stated as follows:

> "Like earlier Acts, the Revenue Act of (May 28) 1938, as proposed and enacted, contained provisions intended to conform with the authority of Eisner v. Macomber."

Preceding the narrower issue, to wit, whether stock dividends should be taxed as income of the recipient, this Honorable Court discussed in *Eisner* v. *Macomber* the more basic question of what the framers of the 16th Amendment meant generally by the term "income", "as used in common speech, to determine its meaning in the Amendment". It was found that the general definition of income, namely: "* * * The gain derived from capital, from labor, or from both combined, provided it be understood to include profits gained through a sale or conversion of capital assets", contained the same fundamental conception as "clearly set forth in the 16th Amendment." The decision of the appellate court in the case at bar is in conflict with this "fundamental conception" of income in the 16th Amendment, that is, as this term is understood in common speech. In holding the partial repayment of a debt, of which a large part remains unpaid, although the total payments collected exceeded the fair market value at the date of death of the decedent, to be ordinary income, the appellate court in the case at bar disregarded the fact that the power of Congress to tax income is *limited* by the 16th Amendment and that such limitation prevents the taxation of collections on a debt as income because they are not in fact income, that is, as the term "income" is understood and used in common speech and in the 16th Amendment. This constitutional limitation is not to be over-ridden by Congress or disregarded by the courts.

2. The decision of the United States Circuit Court of Appeals for the Third Circuit is in conflict with decisions of this Honorable Court on similar matter.

(a) The decision of the appellate court in the case at bar is in conflict with decisions of this Honorable Court in *Goodrich* v. *Edwards,* 255 U. S. 557, 65 L. Ed. 758, *Walsh* v. *Brewster,* 255 U. S. 536, 65 L. Ed. 762 and *United States* v. *Flannery,* 268 U. S. 98, 69 L. Ed. 865, in that said decision of the court below disregarded the interpretation of this Honorable Court to the effect that the introduction of a basis (March 1, 1913) for the purpose of gain or loss determination constitutes a *limitation* upon "actual" gain, as far as such gain represents "income" as contemplated by the 16th Amendment and defined in *Eisner* v. *Macomber, supra.*

(b) The decision of the appellate court in the case at bar is in conflict with the decision of this Honorable Court in *Dobson* v. *Commissioner of Internal Revenue,* Nos. 44, 45, 46, 47, October Term 1943, Adv. Op. 88 L. Ed. 179, in that by that decision this Honorable Court confirmed the procedure of the Tax Court to look to prior years "to determine the *nature of the recovery, whether return of capital or income,*" and stated:

> "Whether an apparently integrated transaction shall be broken up into several separate steps and whether what apparently are several steps shall be synthesized into one whole transaction is frequently a necessary determination in deciding tax consequences. . . . The Tax Court analyzed the basis of the litigation which produced the recovery in this case and the obvious fact that regarding the series of transactions as a whole it is apparent that no gain was *actually* realized'." (Italics supplied.)

The above decision of this Honorable Court assumes particular significance if applied to the holding of the Tax Court in *Estate of Harris Fahnestock, et al.* v. *Commis-*

sioner of Internal Revenue, 2 T. C. No. 96, in that the court there allowed a partial deduction of a bad debt owed the decedent, the date of death value serving as a basis for the determination of such deduction, and in that in the case at bar neither the decedent, nor his estate, have claimed or received any income tax benefit represented by the difference between the amount advanced by the decedent and the fair market value at the date of his death.

3. The decision of the United States Circuit Court of Appeals for the Third Circuit is in conflict with an interpretation of the United States Court of Claims on the same matter.

The decision of the appellate court in the case at bar is in conflict with an interpretation of the United States Court of Claims in *Elmhirst* v. *United States*, 38 Fed. (2d) 915, in which decision that court stated as follows:

> "It thus seems that had Congress inserted a further provision that when the sale was made by an executor the basis for estimating the gain would be the gain as between the value at the time of the testator's death and the sales price, the *Supreme Court would have held that this was merely a 'limitation' which would not control against the 'actual gain' as shown between the purchase price and the sales price.*" (Italics supplied.)

4. The decision of the United States Circuit Court of Appeals for the Third Circuit is in conflict with other circuit courts of appeal on the same matter.

(a) The decision of the appellate court in the case at bar is in conflict with the decision of *First Savings Bank of Ogden* v. *Burnet*, 53 Fed. (2d) 919, decided by the United States Court of Appeals for the District of Columbia, holding that, in construing the term "*sale or other disposition*", the rule of *ejusdem generis* is applicable.

(b) The decision of the appellate court in the case at bar is in conflict with the decision of the United States

Circuit Court of Appeals for the Fifth Circuit in *United States* v. *Carter,* 19 Fed. (2d) 121, holding that a claim of a decedent, although more was collected thereon than was assumed to be the fair market value at the date of death of the decedent, was "part of the corpus of the estate of the decedent", an "integral part of the corpus of the estate", stating as follows:

> "What the appellees (to wit, the executors of the estate) have received from that source came to them as part of the corpus of the estate of the deceased. *They have not sold, converted, or otherwise disposed of that asset, or any part of it.* No income accrued to the estate of the deceased, or to the executors of his will, from the fact that the executors, in making the return for estate tax purposes, estimated the value of deceased's interest in his firm at less than it actually was worth. *All along the appellees were entitled to what the deceased's interest in the firm actually was worth.*" (Italics supplied.)

5. The decision of the United States Court of Appeals for the Third Circuit is in conflict with the position taken by the Commissioner of Internal Revenue in a factual situation analogous in principle and a decision of the Board of Tax Appeals, now the Tax Court.

The decision of the appellate court in the case at bar is in conflict with the decision of the Board of Tax Appeals, now the Tax Court, in *Estate of Edith Findlay,* 46 B. T. A. 1214, in which case the Commissioner of Internal Revenue took the position that the receipt of property, consisting of stocks, bonds and cash from the testatrix by the estate of a devisee is not a disposition within the meaning of the statute, and, therefore, the petitioner is not entitled to deduct any loss represented by the difference in value between the assets received by the estate of the devisee and their fair market value at the date of death of the devisee, the court, in upholding the Commissioner, stating as follows:

"However, assuming for the purpose of discussion that the basis is about $124,000, and even though the fair market value at the date of distribution by the estate of the testatrix was about $98,000, *we can see no disposition within the meaning of Section 111(a), Revenue Act of 1936.* . . . Since the property received was not disposed of in the taxable yar, we fail to perceive anything other than *a mere fluctuation in value which does not give rise to a deductible loss.*" (Italics supplied.)

Wherefore your petitioners respectfully pray that the writ of certiorari be issued out of, and under the seal of, this Honorable Court, directed to the United States Circuit Court of Appeals for the Third Circuit, to the end that the decision of the United States Circuit Court of Appeals for the Third Circuit, rendered in the case numbered and entitled on its Docket No. 8500, Estate of John W. Herbert, Deceased, Central Hanover Bank and Trust Company et al., *Petitioners,* v. Commissioner of Internal Revenue, *Respondent,* be reviewed and determined by this Honorable Court and your petitioners may have such other and further relief in the premises as to this Honorable Court may seem meet and just.

RAYMOND F. GARRITY,
Attorney for Petitioners.

WALTER R. SCHOENBERG,
Of Counsel.

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v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent.*

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

I.

OPINIONS BELOW.

The Tax Court entered a Memorandum Findings of Fact and Opinion on March 4, 1943, and a decision pursuant thereto on May 20, 1943, sustaining the Commissioner of Internal Revenue to the effect that the difference between the fair market value at the date of death of the decedent and the amount of cash and its equivalent received by the petitioners as executors must be taxed as ordinary income of the estate. This opinion and decision is set forth in the Record at pages 20(a) to 21(a). The opinion of the United States Circuit Court of Appeals for the Third Circuit has been reported in Adv. Op. 139 Fed. (2nd) 756.

It was delivered on December 30, 1943, and will be found on pages 22 to 27 of the Record. The docket number of this case in the United States Court of Appeals for the Third Circuit is 8500.

II.

JURISDICTION.

The judgment of the United States Circuit Court of Appeals for the Third Circuit was entered December 30, 1943 (R. 28), and Petition for Rehearing denied February 4, 1944 (R. 38).

The jurisdiction of this Honorable Court is invoked under Section 240(a) of the Judicial Code, as amended (28 U. S. C. Sec. 345 (a)) and by virtue of alleged violation of the Sixteenth Amendment of the Constitution.

III.

STATEMENT OF THE CASE.

A full statement of the case has been given under heading A, Subsection 1 of the Petition for Writ of Certiorari filed herewith, and, in the interest of brevity, is not repeated here.

IV.

SPECIFICATIONS OF ERRORS.

The United States Circuit Court of Appeals for the Third Circuit erred:

1. In finding (a), that the collection on account of the notes and the open book accounts from People's Realty Company, the debtor corporation, in excess of the fair market value at the date of death of the decedent was a "disposition" of property within the meaning of Section 111 of the 1938 Revenue Act or corresponding section of the Internal Revenue Code, and (b), that, even if there were no "disposition" of property, in the statutory sense

of that word, Section 22(a) of the 1938 Revenue Act, or the corresponding section of the Internal Revenue Code, is broad enough to include receipts of the nature involved in the case at bar.

2. In disregarding the basic definition of income as given in *Eisner* v. *Macomber,* 252 U. S. 189, 64 L. Ed. 521, that is to say, as that term is used in common speech and in the 16th Amendment.

3. In disregarding the doctrine pronounced by this Honorable Court, to the effect that under similar factual circumstances pertaining to the basis of March 1, 1913, such basis can, in the light of the 16th Amendment and its authoritative interpretation in *Eisner* v. *Macomber, supra,* be considered only as a limitation on "actual" gain or "actual" loss, the Court of Claims having suggested in *Elmhirst* v. *United States,* 38 Fed. (2d) 915, that this Honorable Court would hold likewise in the case of a date of death value basis.

4. In disregarding the undeniable fact that no part of the difference between the face amount of the debt owed by People's Realty Company and its date of death value has ever been claimed as a bad debt deduction either by the decedent, or his estate, resulting in an income tax benefit, so as to characterize later recoveries as income.

V.

THE QUESTIONS INVOLVED.

The questions involved are the same as those submitted to the United States Circuit Court of Appeals for the Third Circuit and are set forth under the heading A, Subsection 2 of the Petition for the Writ of Certiorari filed herewith.

VI.

ARGUMENT.

A.

There was no "sale or other disposition" of property as required by, and within the meaning of, Section 111 (a) and (b) of the Revenue Act of 1938 (corresponding Section of the Internal Revenue Code).

(a) Section 22(f) of the Revenue Act of 1938 (52 Stat. 447, Ch. 289) (corresponding section of the Internal Revenue Code) provides as follows:

> "(f) *Determination of Gain or Loss.*—In the case of a *sale or other disposition* of property, the gain or loss shall be computed as provided in section 111." (Italics supplied.)

Section 111 of the Revenue Act of 1938 (corresponding section of the Internal Revenue Code) reads, in part as follows:

> "Sec. 111. *Determination of Amount of, and Recognition of, Gain or Loss.*
>
> (a) *Computation of Gain or Loss.*—The gain from *the sale or other disposition* of property shall be the excess of the amount realized therefrom over the adjusted basis provided in section 113(b) for determining gain, and the loss shall be the excess of the adjusted basis provided in such section for determining loss over the amount realized.
>
> (b) *Amount Realized*—The amount realized from *the sale or other disposition* of property shall be the sum of any money received plus the fair market value of the property (other than money) received." (Italics supplied.)

It is respectfully submitted that the meaning of the word "disposition", as used in the above quoted statutory provisions, is definitely limited by the words preceding it,

to wit, "sale or other". Clearly, it does not mean *any other disposition,* regardless of the legal character and economic significance of such disposition. For example, it, obviously, does not include a gift, although a gift is, of course, a disposition of property on the part of the donor. It likewise does not include the disposition of property by a transfer in kind from an executor to a residuary legatee.

In *First Savings Bank of Ogden* v. *Burnet,* 53 Fed. (2d) 919, the United States Court of Appeals for the District of Columbia has pointed out the limited meaning of the term "sale or other disposition". In construing Section 202(a) of the Revenue Act of 1921, a predecessor of Section 111, which provided that the basis for ascertaining gain derived, or loss sustained, from a "sale or other disposition" of property, shall be the cost of such property, the court stated as follows:

> "The question remains whether the transfer, even if not a sale, responds to the description of 'other disposition of property', as employed in the statute. This question is not free from doubt but *we feel constrained to hold that the rule of ejusdem generis is applicable in construing the phrase, and that it relates only to such dispositions of property as are like sales.*" (Italics supplied.)

In order to realize a gain, or to sustain a deductible loss, therefore, the taxpayer must make his property the subject of a sale or a transaction like a sale, meaning in the nature, or of the character, of a sale, that is to say, a transaction which permits at its close the *differentiation* between the property disposed of and the property received. To express it somewhat differently: *In order to determine the differential gain as contemplated in the above quoted section 111, it must be possible to differentiate at the close of the transaction between the value of property parted with and the value of property reciprocally received.* Consequently, the question arises with respect to the case at bar: Was the collection of money and its

equivalent by the executors of the Estate of John W. Herbert, in partial repayment of cash loans made by the decedent, a transaction which permitted at its close the differentiation between values of reciprocal considerations? The answer is obvious. *There occurred no such transaction.*

The Tax Court, in its Memorandum Opinion of March 4, 1943 (R. 21a), appears to admit this, when, in denying,—it is believed, correctly,— the petitioners' alternative claim that, if the collections in question should be found taxable at all, they should be taxed as capital gain, said court stated:

> "Petitioners sold no asset. *On the contrary, a claim which they held was liquidated in part. Peoples received nothing but a pro tanto release from liability.*" (Italics supplied.)

What, then, occurred in the present case? It is respectfully submitted that the decedent, in making the cash loans and advances in the amount stated, parted, at that time, with personal property, that is to say, changed a chose in possession into a chose in action, which includes all rights to personal property except possession. As such, it was acquired by the estate from the decedent. Regardless, therefore, of any valuation placed on such chose in action in pursuance of Section 113(a) (5) of the Revenue Act of 1938 (corresponding section of the Internal Revenue Code), that is, its "fair market value" at the date of death of the decedent, *any partial regaining of possession, any partial reduction of the property to the state in which it was in the hands of the decedent before he turned it into a chose in action, that is, made the loans, is the very antithesis of "disposing" of property.*

> "To pass an article over into the control of another, to part with it, to relinquish it, to get rid of it, actually to remove it, is to dispose of it. Webster's Dict.; (Citations) (*Dayton Brass Castings Co.* v. *Gilligan*, 267 Fed. 872, 878.)

Regardless of the fact that a chose in action originates in a bailment or a loan, the regaining of possession of either the identical property, as in the case of bailment, or of fungible property of equal value, as in the case of a loan, means in both cases to implement the title in, or the right or claim to, the property, which was in the estate from the date of the death of the decedent, *by actual possession thereof,* that is, to achieve again that most comprehensive form of ownership which the decedent enjoyed prior to the making of the bailment or the loan. *It is exactly the opposite of alienating, parting with, or the passing of the property into the control of another; it is, in fact, the taking of the property out of the control of another, a retention not a "disposition" thereof.*

Counsel for the petitioners respectfully submit, had the facts of the case at bar involved a bailment of tangible personal property, instead of a loan of money, and had the fair market value of the bailed property at the date of death of the bailor been less, for some reason, than the value of such property at the date when it was actually restored *in specie* to the possession of the executors of the bailor, that no question of taxable gain could, conceivably, have arisen. *And this is so, even if the assumed bailment would have been a bailment of money.** It is inconceivable to counsel for the petitioners that a change in the relation between the parties to a bailment of money into that of a debtor and creditor, as they would have the right to do (see: *Hargis* v. *Spencer,* 524 Ky. 297, 71 S. W. (2d) 666, 96 A. L. R. 903), can in any way affect the essential fact that the restoration to possession, be it by way of collection of a debt or be it by turning the bailed property back *in specie,* is not a "disposition" of property. As the Tax Court has stated correctly: "*On the contrary,*

* Suppose such bailment of money was made as a special deposit [9 C. J. S. 562, Sec. 274] for the purpose of safekeeping. Thereafter, such money became subject to an attachment on an alleged claim to it by a third party and the bailee interpleads both, bailor and third party. The date of death value reflects this situation.

a claim which they held was liquidated. Peoples received nothing but a pro tanto release from liability". In other words, the transaction did not furnish the basis for a comparison of values resulting in a differential called either gain or loss, respectively.

Contrary to the foregoing considerations the appellate court in the case at bar concluded as follows:

> "We have no doubt that the payment here of the claim held by the estate was a disposition of the claim within the meaning of Section 111." (R. 27.)

It is respectfully submitted that by thus holding said court is also in conflict with what the Circuit Court of Appeals for the Fifth Circuit has stated in *United States* v. *Carter*, 19 Fed. (2d) 121, to wit:

> "In Eisner v. Macomber, 252 U. S. 189, 40 S. Ct. 189, 64 L. Ed. 521, 9 A. L. R. 1570, income was defined as the gain derived from capital, from labor, or from both combined, including profit gained through a sale or conversion of capital assets. The court's analysis and elucidation of that definition in that case and in later cases (Citations) *make it plain that a mere growth or increment in the value of an asset, which is not sold or otherwise disposed of by the owner, is not income.* As defined in section 213 of the Revenue Act of 1921. . . . , gross income includes gains, profits, and income derived from . . . sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property.
>
> "As recognized by the appellees, the interest of the deceased's estate in the partnership of which he was a member at the time of his death was the right to receive a designated share of the net amount realized from the business which was in the hands of the firm at that time. *What the appellees have received from that source came to them as part of the corpus of the estate of the deceased. They have not sold, converted, or otherwise disposed of that asset, or any part of it. No income accrued to the estate of the deceased, or to to executors of his will, from the fact that the executors, in making the return for estate tax purposes, esti-*

mated the value of deceased's interest in his firm at less than it actually was worth. All along the appellees were entitled to what the deceased's interest in the firm actually was worth.

"The difference between the estimated value at one date and the greater ascertained actual value at a later date of an asset retained by its owner is not income, within the definitions given in the above-cited statute and decisions. The item in question was an integral part of the corpus of the estate, *received and retained by the executors, not a gain or profit issuing and severed from a capital asset. It does not include any earnings or revenue produced by capital after it came into the possession of the executors. It is not taxable as income, on the ground that it is the difference between the value of the property at the time it was acquired and a higher value at which it was sold or otherwise disposed of. Being merely the amount of the difference between the estimated and actual value of an asset which remains unconverted or undisposed of, it does not represent a profit or gain which is taxable as income."* (Italics supplied.)

Inferentially, at least, the Board of Tax Appeals, now the Tax Court, has also held to the same effect. In the relatively recent case of *Estate of Edith Findlay*, 46 B. T. A. 1214, the following factual situation was presented:

On June 21, 1933, Octavia Wilson Merritt, hereinafter referred to as the testatrix, died. Edith Findlay, hereinafter referred to as the decedent, was a devisee of testatrix and died December 20, 1936. The balance sheet of the estate of testatrix as of that date showed the share of the decedent to be worth $124,463.04.

On April 1, 1937 the estate of the testatrix distributed to the estate of the decedent stocks, bonds and cash in the net amount of $98,126.99, computed at the fair market value as of the date of distribution.

The issue was whether the petitioner as executor of the estate of the decedent, is entitled to deduct a claimed loss of $25,664.40.

The petitioner contended that the fair market value of decedent's interest in the estate of the testatrix at the date of decedent's death was $124,463.04, and that this is the basis of the property in the hands of the petitioner. It was further argued that, since the fair market value of the property and cash collected by him in 1937 was only $98,126.99, the estate of the decedent had a deductible loss upon the liquidation of the estate of the testatrix.

The position of the Commissioner of Internal Revenue, however, was that the receipt of property, collected on the claim against the estate of the testatrix upon liquidation of that estate,—despite the provision of Section 111(b) to the effect that the realization of gain or loss may be based upon the fair market value of property received,—is not a disposition of the claim within the meaning of the statute, and, therefore, petitioner is not entitled to deduct any loss *"until there is some disposition of the property received"*.

This position of the Commissioner was sustained by the Board. *Inter alia* it stated as follows:

> "However, assuming for the purpose of discussion that the basis is about $124,000, and even though the fair market value at the date of distribution by the estate of the testatrix was about $98,000.00, *we can see no disposition within the meaning of the Section 111(a), Revenue Act of 1936.*
>
> *Since the property received was not disposed of in the taxable year, we fail to perceive anything other than a mere fluctuation in value which does not give rise to a deductible loss."* (Italics supplied.)

It is respectfully submitted that the gain or loss provisions are, of course, correlated; that is to say, if in the *Findlay* case there was no deductible loss, there could be no taxable gain, if, instead of a depreciation, there had been an appreciation in value. The conclusion is unavoidable that in neither event would there be a "disposition" within the meaning of Section 111 of the Revenue Act of 1938 (corresponding provision of the Internal Revenue Code).

As a further illustration of the results to which the holding on this point of the appellate court in the case at bar would logically lead, is the hypothetical case, for example, of a specific bequest of real estate, the title to which, at the date of death of the testator, is challenged, in consequence whereof the fair market value at such date had to be assumed considerably below the actual value of the property. If, after successful termination of the litigation, the fee of the property is judicially determined to be in the devisee, its value to such devisee would, of course, be considerably enhanced. Under the doctrine as enunciated by the court below,—to wit, that the satisfaction or collection of a claim is a "disposition" thereof in the statutory sense, the difference between the date of death value of the devisee's claim to the specifically bequeathed real estate and its actual value upon confirmation of title in the devisee, would be taxed as ordinary income. Quite obviously, any such result is contrary not only to the legislative intent embodied in Section 111, but also to what the term "income" is understood to mean in common speech and in the 16th Amendment.

In view of the foregoing argument on this point, counsel for the petitioners respectfully submit that the partial collection of a debt by the executors does not constitute a "sale or other disposition" of property within the meaning of this term as used in section 111 of the Revenue Act of 1938 (corresponding section of the Internal Revenue Code). The term "sale or other disposition", as well as the term "sale or exchange", as used in the same and other sections of the 1938 Act or the Internal Revenue Code, "like other words in a revenue act, is to be accorded its *ordinary meaning* and is not to be tortured into strained construction." (*William Flaccus Oak Leather Co.* v. *Commissioner of Internal Revenue*, 114 Fed. (2d) 783, reversed on other grounds 313 U. S. 247, 85 L. Ed. 1310). This should be *a fortiori* true in cases where such strained construction does not only violate the legislative intent of

a particular statute *but leads to a concept of "income" which is entirely foreign to the constitutional meaning of that term.*

(b) The appellate court in the case at bar, referring to the case of *Helvering* v. *Roth,* 115 Fed. (2d) 239, stated as follows:

> "An alternative theory was suggested by Judge Learned Hand in Helvering v. Roth, supra, which involved the same issue now under consideration. In both cases, it is clear that the difference between the value of the claim on the date of death and the subsequent amount received on the claim, constituted a gain to the estate. *It was pointed out in the Roth case that 22(a) is broad enough to include this sort of gain,* Judge Hand noting that Congress was probably not so inept as to let such an obvious gain escape taxation." (Italics supplied.) (R. 27.)

In answer to this so-called "alternative theory", counsel for the petitioners respectfully submit that Congress has prescribed, by Section 22(f), a definite and exclusive method for the determination of differential gain or loss in Sections 111(a) and (b). The very fact moreover, that Section 113(a) (5) of the Revenue Act of 1938 (corresponding section of the Internal Revenue Code) prescribes a specific basis for property transmitted at death, permits *only one* conclusion, namely, that possible taxable gain or deductible loss *must* be determined by, and measured as, a deviation from such basis in conformity with Section 111(a) and (b). The application, however, of the method of computing differential gain or loss prescribed in that section is definitely restricted by statutory mandate: *There must be a "sale or other disposition" of property. If no "sale or other disposition" of property, permitting a comparison of values resulting in a differential called gain or loss, respectively, has occurred, there is, or, obviously, can be, no tax provoking incident.*

It should be expressly stated that this is *not* due, as is indicated it would be in *Helvering* v. *Roth, supra,* to the fact that the statutory "language was so inept as to let such a case escape through its meshes", but, on the contrary, is in complete harmony with the commonly accepted meaning of, and distinction between, the terms "income" and "return of capital".

It is respectfully submitted that the "alternative theory" suggested in *Helvering* v. *Roth, supra,* adopted and approved by the appellate court in the case at bar, in referring the collections here in question solely to the statutory provisions of what shall be included within gross income (Section 22(a)), assumes not only for granted that such collections are "income" within the meaning of this term in common speech and the 16th Amendment, but also fails to observe that, if those collections were covered *alone* by section 22(a) of the Revenue Act of 1938 (corresponding section of the Internal Revenue Code), they would have to fall into one of the categories of gross income there enumerated *in their entirety,* whereas admittedly, only the *difference* between the date of death value and the amount actually collected could, possibly, be income under any circumstance.

(c) Counsel for the petitioners respectfully submit, that in *Helvering* v. *Roth, supra,*—which case the Tax Court as well as the appellate court below have held to be governing for the decision in the case at bar (R. 21a, 27)—this "alternative theory", conceivably, was properly applied *in that the particular facts of that case permitted such application.* In the *Roth* case, no cash loans or advances by the decedent were involved. The decedent there procured money for a corporation by way of accommodation endorsement before the notes were delivered to, and endorsed by, the payee, that is to say, "the law presumes that he intended to give it credit by becoming liable to pay it, either as guarantor or as an original promisor." (See: *Good* v. *Martin,* 95 U. S. 90, 24 L. Ed. 341; *Lang et al.* v.

Commissioner of Int. Rev., 32 B. T. A. 522). After his death, his trustees *continued to procure money in the same manner for the same corporation, despite the fact that the estate was holding previously defaulted notes, which the decedent had paid, with the obvious purpose of financing the operations of the corporation to a point where their ultimate financial success would permit the corporation to make good its prior defaults and enable the trustees to retrieve an otherwise lost investment of their decedent.* The continued cooperation and participation in the operations of the corporation on the part of the estate by the *active employment of capital*, makes the relationship existing between the trustees, representing the estate, and the corporation that of partners in a joint venture, and the payments received by them, seventeen years after the default by the maker of the notes, *were in reality proceeds of additional capital employed by the estate, or "gain derived from capital"*. If the "apparently integrated transaction" involved in the *Roth* case is thus "broken up into several separate steps" (*Dobson* v. *Commissioner of Internal Revenue*, Nos. 44, 45, 46, 47, October Term 1943, Adv. Op. 88 L. Ed. 172), it appears perfectly reasonable under these circumstances to refer the receipts of money by the trustees *solely* to the statutory definition of gross income in Section 22(a), because no determination of *differential* gain would then be required.

B.

Eisner v. Macomber, 252 U. S. 189, remains the authoritative interpretation of what constitutes income under the 16th Amendment.

In *Helvering* v. *Griffith*, 318 U. S. 371, 87 L. Ed. 843, this Honorable Court refused the request of the Commissioner of Internal Revenue to overrule *Eisner* v. *Macomber*, *supra*. This request on the part of the Government was prompted by the desire to obtain a different ruling on the

narrower issue of the case, which involves the problem whether stock dividends should be taxed as *income* of the recipient. The more basic question is, obviously, what the framers of the 16th Amendment meant *generally* by the term *"as used in common speech, to determine its meaning in the Amendment,"* that is, without forming "also a correct judgment as to the nature of a stock dividend", and then arrive at a synthesis of both.

The adopted *general* definition of income to wit: "The gain derived from capital, from labor, or from both combined, provided it be understood to include profits gained through a sale or conversion of capital assets", remains unchallenged, and so remains its kinship to the 16th Amendment, to wit: *"The same fundamental conception is clearly set forth in the 16th Amendment."*

This limitation on the power of Congress to tax income prevents the taxation of what is not in fact income. It must be *income* as this term is understood in common speech, without regard to form. It is respectfully submitted that this limitation, despite the necessity of the times for unprecedented revenue, cannot be overridden by Congress or disregarded by the Courts.

Referring to the above-quoted general definition of income, this Honorable Court in *Eisner* v. *Macomber, supra,* has stated as follows:

> "Brief as it is, it indicates the characteristic and distinguishing attribute of income, essential for a correct solution of the present controversy. *The government, although basing its argument upon the definition as quoted, placed chief emphasis upon the word 'gain', which was extended to include a variety of meanings; while the significance of the next three words was either overlooked or misconceived, . . . 'derived . . . from . . . capital'; . . . 'the gain . . . derived . . . from capital,' etc. Here we have the essential matter; not a gain accruing to capital, not a growth or increment of value in the investment; but a gain, a profit, something of exchangeable value proceeding from the property, severed from the capital, however invested or em-*

ployed, and coming in, being 'derived', that is, received or drawn by the recipient (the taxpayer) for his separate use, benefit, and disposal; *that is income derived from property. Nothing else answers the description.*" (Italics supplied.)

It is respectfully submitted that under no conceivable aspect do the facts of the case at bar show, or can they be construed to show, the criterion of "derivation" from a source, in the sense in which this Honorable Court has illustrated the derivative process by contrasting *capital* and *income*, "the former being likened to the tree or the land; the latter to the fruit or the crop; the former depicted as a reservoir supplied from springs, the latter as the outlet stream, to be measured by its flow during a period of time."

By no process of reasoning, counsel for the petitioners contend, can, in the case at bar, the fact be disputed, or tortured into an almost cabalistic scheme intending to disprove such fact, namely, *that of the total cash loans and advances made by the decedent to People's Realty Company, an amount of $236,014.14 remains in fact unpaid, that is, actually lost.*

If the court below states:

> "* * * it is clear that the difference between the value of the claim on the date of death and the subsequent amount received on the claim, constituted a gain to the estate" (R. 27),

may not, with much more justification in regard to reality, the statement be made: There was a *loss* to somebody, *a loss for which neither the decedent, his estate, nor his beneficiaries ever claimed, ever received, or will receive, an income tax benefit!*

In the face of the unchallengeable fact that $236,014.14 was actually lost, it is respectfully submitted, any conclusion which arrives at a *taxable profit or gain of $95,611.71*, for the two taxable years involved, must have been reached

by resorting to methods of arithmetic which are definitely not in common use, *leading to a conception of "income" which is the exact opposite of the meaning of this term as used in common speech and in the 16th Amendment.*

It is in the light of the authority of the 16th Amendment, and the foregoing considerations based thereon, that the contention of the Commissioner of Internal Revenue and the reasoning of the preceding courts must be tested, that is, more specifically, *whether the introduction of a basis in conformity with Section 113(a) (5) may, in application to the facts of the case at bar, be used for the purpose of making income out of what is not, and cannot, be income as this term is "used in common speech" and in the 16th Amendment.* It is respectfully submitted that the attempt to make the collections here involved taxable income by medium of a hypothetical value placed on a money debt as of the date of death of the creditor, *which, in truth,—the value of the monetary unit, at least for domestic purposes, being conclusively presumed of remaining constant,—is no valuation at all, but merely a guess as to the instant, not prospective, collectibility of all the monetary units comprising such debt, is violative of what the 16th Amendment and its authoritative interpretation in Eisner* v. *Macomber, supra, have declared to be constitutionally "income".*

C.

Congress intended to tax "actual", not fictitious, gains, and to permit the deduction of "actual", not fictitious, losses, and, consequently, any statutory basis must be considered only as a limitation upon such "actual" gain or loss.

It is respectfully submitted that the basis provided for by Section 113(a) (5) of the Revenue Act of 1938 (corresponding section of the Internal Revenue Code) may not be used, under the guise of the doctrine of the separate taxable entity of an estate, for the purpose of making in-

come out of what is not in fact income, that is, contrary to the meaning of this term in common speech and in the 16th Amendment. With respect to the basis of March 1, 1913, as, for example, provided for in Section 202(a) of the Revenue Act of 1918, this Honorable Court has held in *United States* v. *Flannery*, 268 U. S. 98, 69 L. Ed. 865, following its prior decisions in *Goodrich* v. *Edwards*, 255 U. S. 527, 65 L. Ed. 758, and *Walsh* v. *Brewster*, 255 U. S. 536, 65 L. Ed. 762, as follows:

> "* * * it should be held that the Act of 1918 imposed a tax and allowed a deduction to the extent only that an *actual* gain was derived or an *actual* loss sustained from the investment, and *that the provision in reference to the market value on March 1, 1913, was applicable only where there was such an actual gain or loss; that is, that this provision was merely a limitation upon the amount of the actual gain or loss that would otherwise have been taxable or deductible.*" (Italics supplied.)

Assuming the contention that Congress intended, in obedience to the 16th Amendment, only to tax an "actual", not a fictitious, gain and to permit, as a correlate thereto, the deduction of an "actual", not a fictitious loss, to be correct and unchallengeable, counsel for the petitioners submit, that Section 202(a), together with Section 213, of the 1918 Revenue Act (R. 4a) and Section 113(a) (5), in conjunction with Sections 22(a) and 111(a) and (b) of the 1938 Revenue Act (corresponding sections of the Internal Revenue Code) (R. 1a-3a) *embody the identical principle, to wit, the determination of taxable income as the upward deviation from a given hypothetical value basis, realized by means of a sale or other disposition of property, and the rationale and scope given to this principle by this Honorable Court in the Flannery case, involving the 1918 Act, should not be disregarded in the application of the same principle under Section 113(a) (5) of the 1938 Act.* This contention of counsel for the petitioners is prompted by a

statement of the Court of Claims, which in *Elmhirst* v. *United States,* 38 Fed. (2d) 915, by way of interpretation, said:

> "In the case of United States v. Flannery, 268 U. S. 98, 101, 45 S. Ct. 420, 69 L. Ed. 865, after citing the cases of Goodrich v. Edwards, 255 U. S. 527, 41 S. Ct. 390, 391, 65 L. Ed. 758, and Walsh v. Brewster, 255 U. S. 536, 41 S. Ct. 392, 65 L. Ed. 762, the Supreme Court held that it was the intention of Congress only to levy a tax upon an 'actual' gain as between the purchase price and the selling price, even though the gain thus shown was less than the gain shown between the value as of March 1, 1913, and the selling price, and that only such 'actual gain' was subject to tax, even though a different and larger one was shown between the fictitious values of March 1, 1913, and the selling price, and that this fictitious gain was not intended to be the controlling basis and could not be taken as the basis for ascertaining the tax as against 'actual' gain.
>
> "*It thus seems that had Congress inserted a further provision that when the sale was made by an executor the basis for estimating the gain would be the gain as between the value at the time of the testator's death and the sales price, the Supreme Court would have held that this was merely a 'limitation' which would not control as against the 'actual gain' as shown between the purchase price and the sales price.* (Italics supplied.)

D.

The application of a basis under Section 113(a)(5) of the Revenue Act of 1938 (corresponding section of the Internal Revenue Code) to a money debt amounts in effect to a statutory write-off of a bad debt to the extent to which the so-called fair market value at the date of death indicates such debt as not being fully collectible at that date.

Counsel for the petitioners respectfully submit that the mandatory appraisal of the debt owed the decedent, or his estate, by People's Realty Company, as of the date of death, at less than its full amount, is equivalent to a

write-off, forced upon the taxpayer by statute, to the extent to which the so-called fair market value, that is the *instant collectibility,* is below the full collectibility of the sum of money actually loaned to People's Realty Company. As a matter of fact, the date of death value has served as a basis for the deduction of a partially bad debt owed the decedent, and, as such, was confirmed by the Tax Court in *Estate of Harris Fahnestock* v. *Commissioner of Internal Revenue,* 2 T. C. No. 96. On the other hand, this Honorable Court has only recently confirmed, in *Dobson* v. *Commissioner of Internal Revenue,* Nos. 44, 45, 46, 47, October Term 1943, Adv. Op. 88 L. Ed. 179, the close interrelationship between bad debt deductions and the "tax benefit theory", and recognized an inquiry into past years as a proper method for the purpose of determining the nature of later recoveries, "whether return of capital or income." In the case at bar, neither the decedent, nor his estate or beneficiaries, have ever claimed or received an income tax benefit on account of the compulsory charge-off in consequence of the application of Section 113(a) (5) of the Revenue Act of 1938 (corresponding Section of the Internal Revenue Code). Assuming, for the purpose of the argument only, that the decedent had voluntarily taken a bad debt deduction, *without,* however, a resulting income tax benefit, would not later recoveries, under the authority of the *Dobson* case, definitely have been characterized as *returned capital?* Why should they lose this character because the taxpayer died and his estate became the recipient? It is respectfully submitted, that, once this character of "returned capital" has attached, by reason of the absence of a related income tax benefit, it makes future recoveries as much a part of the corpus of the estate, that is, of what was "acquired by the decedent's estate from the decedent", as are the assets *in praesenti.* To determine the character of such later recoveries, it appears, also under the authority of the *Dobson* case, that it is permissible to "consider such facts with relation to the taxes

for other taxable years as may be necessary correctly to redetermine the amount of such deficiency."

VII.

CONCLUSION.

It is, therefore, respectfully submitted that this case is one calling for the exercise by this Honorable Court of its supervisory powers in order that the decision of the United States Circuit Court of Appeals for the Third Circuit be reversed and that to such an end a writ of certiorari should be granted and this Honorable Court should review the decision of said appellate court and finally reverse it.

RAYMOND F. GARRITY,
Attorney for Petitioners.

WALTER R. SCHOENBERG,
Of Counsel.

BEFORE THE

Supreme Court of the United States

OCTOBER TERM, 1943

No. ——

ESTATE OF JOHN W. HERBERT, Deceased, CENTRAL HANOVER BANK AND TRUST COMPANY, ET AL., Executors,
Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent.*

MOTION AS TO RECORD.

To the Honorable, the Chief Justice and Associate Justices:

Petitioners move that their Petition for Writ of Certiorari to the United States Court of Appeals for the Third Circuit may be considered upon the Appendix to the Brief of the petitioners filed in this cause in said Circuit Court of Appeals, and upon the Proceedings and Opinion in that Court, and for reasons therefor respectfully show:

1. The Appendix to said brief contains all pertinent facts and prior proceedings.

2. Certified copy of said Appendix, and of said Proceedings and Opinion, have been lodged with the Clerk of this Court, along with ten plain copies of said Appendix and said Opinion.

3. No reference is made in their Petition to any portion of the record not contained in said Appendix or the said Proceedings and Opinion.

4. If the Writ of Certiorari prayed for in the Petition is granted, petitioners will promptly supply the requisite additional printed copies of said Appendix and of said Proceedings and Opinion.

Respectfully submitteed,

RAYMOND F. GARRITY,
Attorney for the Petitioners.

WALTER R. SCHOENBERG,
Of Counsel.

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In the Supreme Court of the United States

OCTOBER TERM, 1943

No. 937

ESTATE OF JOHN W. HERBERT, DECEASED, CENTRAL HANOVER BANK AND TRUST COMPANY, ET AL., EXECUTORS, PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The memorandum opinion of the Tax Court of the United States (R. 20a–21a) is not officially reported. The opinion of the Circuit Court of Appeals (R. 22–27) is reported at 139 F. 2d 756.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on December 30, 1943 (R. 28), and petition for rehearing was denied February 4, 1944

(R. 38). The petition for a writ of certiorari was filed on April 27, 1944. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

The estate of the decedent acquired a claim from the decedent on which it realized amounts in cash and property in excess of the fair market value of the claim as of the date of the decedent's death. The question is whether this excess is taxable income to the estate.

STATUTES AND REGULATIONS INVOLVED

The applicable statutes and regulations are set out in the Appendix, *infra*, pp. 11–13.

STATEMENT

The facts reflected by the stipulation of facts (R. 18a–19a), findings of the Tax Court (R. 20a) and the Commissioner's deficiency letter, attached as an exhibit to the petition for review by the Tax Court (R. 11a–17a), may be summarized as follows:

Petitioners are the executors of the estate of John W. Herbert, deceased. The decedent died on August 26, 1934, owning a claim against Peoples Realty Company, a New Jersey corporation, all of whose stock he held. The claim was in the face amount of $531,817.75 and was represented partly by notes and partly by an open account. (R. 19a.)

The fair market value of the claim on the date of death was $200,191.90. Petitioners collected $282,500 in cash from Peoples on account of the claim, of which $155,000 was collected by the end of 1937, $127,000 during 1938, and $500 during 1939. In addition, petitioners received interests in two mortgages in 1939 on account of the claim. The aggregate fair market value of these interests at the time of their transfer was $13,303.61 (R. 19a.)

In the 1938 and 1939 income tax returns filed by the executors of the estate of the decedent there were reported as capital gains amounts collected in 1938 and 1939 in excess of the fair market value of the claim at the date of the decedent's death (R. 14a, 16a). The Commissioner adjusted the returns by excluding these reported amounts as capital gain and by adding the total of the excess to ordinary income in the amount and year received (R. 12a–17a).

In the Tax Court petitioners contended that the excess was not taxable income and, in the alternative, that it was taxable only on a reduced basis as capital gain. The Tax Court rejected both contentions and affirmed the Commissioner's determination. (R. 20a–21a.) Petitioners abandoned the alternative contention on appeal to the Circuit Court of Appeals (Br. 16) and that court affirmed the decision of the Tax Court on the ground that the excess was taxable income (R. 22–28).

ARGUMENT

Section 161 (a) (3) of the Revenue Act of 1938 (Appendix, *infra*, pp. 12–13) provides that the income taxes imposed by the Act upon individuals shall apply to the income received by estates of deceased persons. The Act further provides that the basis for determining gain received by an estate from the sale "or other disposition of property" shall be the fair market value of such property at the time of its acquisition and that the recognized gain from the disposition of the property shall be the excess of the amount realized over the fair market value of the property at the time of its acquisition. Sections 22 (f), 111 (a) and (b), 113 (a) (5) and (b) (Appendix, *infra*, pp. 11–12). The Act therefore treats the estate of a decedent as a new and different taxpayer (opinion of the court below, R. 25) which, under Section 22 (a) (Appendix, *infra*, p. 11), is taxable on "gains * * * derived from any source whatever." Petitioners contend, however, that the estate realized no gain or income from the claim it acquired from the decedent (Br. 24–31) and that if it did realize a gain it was not through a "disposition" of property (Br. 14–24).

The argument that the amounts realized by the estate from the claim in excess of the fair market value of the claim at the time of the decedent's death were not gain, or income, rests on the premise that the estate of the decedent

should not be regarded as a taxpayer separate and distinct from the decedent. The premise is fallacious, for the Act treats the estate as a separate taxpayer, as we have shown, and this Court, noting that this treatment has been consistent in the various Revenue Acts, has held that the treatment of the estate as a separate taxpayer is proper. *Hartley* v. *Commissioner,* 295 U. S. 216; *Helvering* v. *Reynolds,* 313 U. S. 428; *Brewster* v. *Gage,* 280 U. S. 327. Thus, as the Court also held in the latter cases, it is proper to compute the gain to the estate on property acquired from the decedent on the basis of the fair market value of the property when the estate acquired it at the decedent's death. Any loss which previously accrued to the decedent between the date of his acquisition of the property and his death is not to be taken into account in computing the tax liability of the estate. *Hartley* v. *Commissioner, supra,* p. 219. The principle applies to claims existing at the date of death as well as to other forms of property. See *Helvering* v. *Roth,* 115 F. 2d 239 (C. C. A. 2d), where it was held that the estate realized income on a claim which had a zero basis on the date of death.

It is therefore inapposite that, as petitioners argue (Br. 29–31), the application of the statutory basis for determining gain to the estate may in effect amount to a write-off of a bad debt so

far as the decedent is concerned.[1] The total by which the amount realized by the estate exceeds the value of the property on the date of acquisition by the estate is an actual gain accruing to capital, or a growth or increment of value in the investment, so far as the estate is concerned. See *Hartley* v. *Commissioner, supra; Helvering* v. *Roth, supra; Blodget* v. *Commisioner,* 13 B. T. A. 1243; *Vanderbilt* v. *Commissioner,* 11 B. T. A. 291; 6 Mertens, Law of Federal Income Taxation, Section 36.25; cf. *Kenan* v. *Commissioner,* 114 F. 2d 217 (C. C. A. 2d); *Suisman* v. *Eaton,* 15 F. Supp. 113 (D. Conn.), affirmed, 83 F. 2d 1019 (C. C. A. 2d), certiorari denied, 299 U. S. 573. It follows that the decision below, holding that the gain to the estate is income, is correct and does not conflict with this Court's decision in *Eisner* v. *Macomber,* 252 U. S. 189, or with the cases cited by petitioners (Br. 6–7, 27–29) as holding that only actual gains are taxable.[2]

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[1] Contrary to petitioners' contention (Br. 30–31), this conclusion is not inconsistent with this Court's decision in *Dobson* v. *Commissioner*, 320 U. S. 489, rehearing denied, 321 U. S. 231. In addition to the fact that that case does not *require* application of the tax benefit theory, it did not involve the application of the theory in connection with separate and distinct taxpayers. Manifestly, the lack of a tax benefit to one taxpayer for a loss on property does not change the nature of the gain on the property by another taxpayer.

[2] *Elmhirst* v. *United States*, 38 F. 2d 915 (C. Cls.), certiorari denied, 282 U. S. 851, is the only case relied upon by petitioners in this connection which involves the basis for de-

Nor is the statutory occasion for attributing gain to the estate inapplicable here, as petitioners contend (Br. 14–24), on the ground that there was no "sale or other disposition" of property within the meaning of Section 111 of the Act. As the court below held (R. 26–27), the relinquishment of the claim by the estate upon payment was a "disposition" of the claim in the elementary and usual sense of the word [3] and the legislative intent to tax gains resulting from such a disposition is clear.[4] *Helvering* v. *Roth, supra.* As pointed out by the court below, the term "disposition" is used in precisely that sense in Section 44 (d) of the Internal Revenue Code. One who purchased a chose in action and afterward collected more upon

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termining gain to an estate. The position taken in that case was based on *McKinney* v. *United States*, 62 C. Cls. 180, and was rejected by this Court in *Hartley* v. *Commissioner*, *supra*.

[3] The early decision in *United States* v. *Carter*, 19 F. 2d 121 (C. C. A. 5th), cited by and quoted from by petitioners (Br. 18–19), does not seem to be inconsistent with this conclusion. In that case the question was as to the value of a partnership interest of the deceased. The facts were such that the executors of his estate could not determine its value and were compelled to make an arbitrary guess for estate tax purposes. The court held that for income tax purposes the difference between the actual value, which later appeared, and the estimated value was not income. It appears that the court was speaking of actual value at the time of the decedent's death.

[4] The decision below is not in conflict with the decision in *First Sav. Bank of Ogden* v. *Burnet*, 53 F. 2d 919 (App. D. C.), in which it was stated that the rule of *ejusdem generis* should be applied in construing the phrase "sale or other

it than he paid, would certainly not escape taxation of the gain upon the theory that he had not made "disposition" of the claim. Petitioners' arguments in this connection that there was no "differential" basis for attributing gain (Br. 15, 22) and that the transaction was a restoration of possession of the money loaned by the decedent, instead of a disposition of the claim acquired by the estate (Br. 16–18), obviously have no merit.

It seems clear, too, that the gain realized by the estate is taxable under the Act regardless of whether the liquidation of the claim involved a disposition of property. Sections 22 (a) and 161 (a) (3) require the estate to pay income tax on gains from whatever source derived. As the Circuit Court of Appeals for the Second Circuit stated in *Helvering* v. *Roth, supra,* which involved the identical question presented in this case, the general intent of Section 22 (a) was to

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disposition" of property contained in Section 202 (a) of the Revenue Act of 1921, c. 136, 42 Stat. 227. That case involved a totally different issue, namely, whether the distribution by a bank to its stockholders of the stock it held in another corporation was a "disposition" of property which entitled the bank to take a loss in the amount of the difference between the cost to it of the stock and its market value at the time of distribution. The court resolved its doubt regarding the construction of the statute as applied to the particular facts by recourse to Treasury Regulations applicable to the analogous situation presented by the distribution of assets of a corporation upon its dissolution.

tax all realized gains and no reason appears for restricting its scope.

Section 113 (a) (5) of the Act provides, without reference to a sale or disposition of property, that the basis of property acquired by a decedent's estate shall be the fair market value of the property at the time of its acquisition, meaning acquisition by the estate at the time of the decedent's death. *Hartley* v. *Commissioner, supra.* Article 111–1 of Treasury Regulations 101 (Appendix, *infra,* p. 13), specifically provides that, even though property is not sold or otherwise disposed of, "gain (includible in gross income under section 22 (a) as 'gains or profits and income derived from any source whatever')" is realized if the sum of all the amounts received which are required by Section 113 (b) to be applied against the basis of the property exceeds such basis. It is significant that this regulation is identical with corresponding provisions of Article 111–1 of Treasury Regulations 86 and 94, promulgated under the Revenue Acts of 1934 and 1936, respectively, and that, in consequence, the clearly stated official interpretation of the applicable statutory provisions has had the confirmation of two re-enactments of the provisions. No reason appears for a changed interpretation now.

CONCLUSION

The case was correctly decided below and involves no conflict of decisions or important, unsettled question of law. The petition for a writ of certiorari should therefore be denied.

Respectfully submitted.

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MAY 1944.

APPENDIX

Revenue Act of 1938, c. 289, 52 Stat. 447:

(a) *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *

* * * * *

(f) *Determination of Gain or Loss.*—In the case of a sale or other disposition of property, the gain or loss shall be computed as provided in section 111.

* * * * *

SEC. 111. DETERMINATION OF AMOUNT OF, AND RECOGNITION OF, GAIN OR LOSS.

SEC. 22. GROSS INCOME.

(a) *Computation of Gain or Loss.*—The gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the adjusted basis provided in section 113 (b) for determining gain, and the loss shall be the excess of the adjusted basis provided in such section

for determining loss over the amount realized.

(b) *Amount Realized.*—The amount realized from the sale or other disposition of property shall be the sum of any money received plus the fair market value of the property (other than money) received.

* * * * *

SEC. 113. ADJUSTED BASIS FOR DETERMINING GAIN OR LOSS.

(a) *Basis (Unadjusted) of Property.*—The basis of property shall be the cost of such property; except that—

* * * * *

(5) *Property Transmitted at Death.*—If the property was acquired by bequest, devise, or inheritance, or by the decedent's estate from the decedent, the basis shall be the fair market value of such property at the time of such acquisition. * * *

* * * * *

(b) *Adjusted basis.*—The adjusted basis for determining the gain or loss from the sale or other disposition of property, whenever acquired, shall be the basis determined under subsection (a), adjusted as hereinafter provided.

(1) *General rule.*—Proper adjustment in respect of the property shall in all cases be made—

(A) for * * * receipts * * * properly chargeable to capital account * * *.

* * * * *

SEC. 161. IMPOSITION OF TAX.

(a) *Application of Tax.*—The taxes imposed by this title upon individuals shall

apply to the income of estates or of any kind of property held in trust, including—

* * * * *

(3) Income received by estates of deceased persons during the period of administration or settlement of the estate; * * *.

* * * * *

The corresponding sections of the Internal Revenue Code are substantially the same as the above sections of the 1938 Act.

Treasury Regulations 101, promulgated under the Revenue Act of 1938:

ART. 111–1. *Computation of gain or loss.*— * * *

Even though property is not sold or otherwise disposed of, gain (includible in gross income under section 22 (a) as "gains or profits and income derived from any source whatever") is realized if the sum of all the amounts received which are required by section 113 (b) to be applied against the basis of the property exceeds such basis.

Section 19.111–1 of Treasury Regulations 103, promulgated under the Internal Revenue Code, is substantially the same as Article 111–1 of Treasury Regulations 101.

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